

VZCZCXRO4169
PP RUEHRG
DE RUEHBR #0206/01 0271115
ZNR UUUUU ZZH
P 271115Z JAN 06
FM AMEMBASSY BRASILIA
TO RUEHC/SECSTATE WASHDC PRIORITY 4365
INFO RUEHSO/AMCONSUL SAO PAULO 6222
RUEHRG/AMCONSUL RECIFE 4250
RUEHRI/AMCONSUL RIO DE JANEIRO 1425
RUEHBU/AMEMBASSY BUENOS AIRES 3743
RUEHMN/AMEMBASSY MONTEVIDEO 6007
RUEHAC/AMEMBASSY ASUNCION 5179
RUEHSG/AMEMBASSY SANTIAGO 5287
RUEHLP/AMEMBASSY LA PAZ 4343
RUEHCV/AMEMBASSY CARACAS 3108
RUEHPE/AMEMBASSY LIMA 2829
RUCPDO/USDOC WASHDC
RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS SECTION 01 OF 05 BRASILIA 000206

SIPDIS

STATE PLEASE PASS TO USTR
NSC FOR CRONIN
TREASURY FOR FPARODI
USDOC FOR 3134/USFCS/OIO/WH/EOLSON
USDOC FOR 4332/ITA/MAC/WH/OLAC/MWARD

SENSITIVE
SIPDIS

E.O. 12958: N/A

TAGS: [ETRD](#) [PGOV](#) [KIPR](#) [ECON](#) [PREL](#) [PINR](#) [BR](#)

SUBJECT: CHARGE ENGAGES SAO PAULO PRIVATE SECTOR ON TRADE
LIBERALIZATION, THE MACROECONOMY, AND BOLIVIA/VENEZUELA

REF: BRASILIA 0141

11. (U) This cable contains business proprietary data.

12. (SBU) Summary. During his January 16-18 economic theme meetings in Sao Paulo, Charge discussed a wide variety of trade, financial and investment issues with key private sector officials. Embassy and Consulate representatives met with leaders at FIESP (the Sao Paulo Industrial Federation, CIESP (FIESP's sister organization), AmCham, Ford Motor Company, Interfarma, and U.S. air carriers to get their views on how best to reinvigorate commercial ties between the two countries. (Civair and pharmaceutical sector discussions reported septel.) Overall, our interlocutors emphasized the following themes: the need to promote greater business-to-business relations given the expected congressional lull in advance of the October 2006 Brazilian elections, ongoing private sector efforts to influence the post-election agenda of the various candidates, preoccupation with the current stalemate on FTAA talks and the limited results of the Doha Round Hong Kong Ministerial, and Brazil's relief that the USG terminated the pending GSP petition on copyright piracy.

13. (SBU) For his part, Charge noted that the FTAA impasse only worked to disadvantage Brazil and that Mercosul, with the addition of Venezuela and the potential entry of Bolivia, risked losing coherence. He made the point that Brazilian industry needed to do a better job of lobbying GOB policymakers as too often the Foreign Ministry sacrificed the country's commercial interests to support the government's pro-third world overseas agenda. End Summary.

Growing Optimism regarding the Brazilian Economy

14. (SBU) Our Brazilian private sector interlocutors expressed increasing confidence with respect to the health of the domestic economy. FIESP and AmCham officials declared that after 10 years of sound economic policies the country was reaping the benefits in terms of low inflation and a positive current account. Attendees at a dinner of local CEOs all noted that 2005 was a good year for big business as exports, combined with awakening internal demand, had

lifted sales. Separately, United and American Airlines reported growing passenger volume and high load factors (the latter with 83%), although high fuel costs made the profit picture iffy.

15. (SBU) Meanwhile, Ford Brasil President Barry Engel stated that his operations have been in the black for seven consecutive quarters, with market share, unit sales, production-line efficiency and exports reaching eight-year highs in 2005. Indeed, increased exports (US\$ 9 billion last year) had buoyed the entire Brazilian auto industry, he said, with domestically produced vehicles headed to such diverse locations as Mexico, Argentina, Turkey, and Syria. Thirty-seven percent of the vehicles sold in Mexico were actually made in Brazil. Nevertheless, Engel admitted, the company faced significant challenges, including excessive taxes (with respect to the auto industry, the highest in the world), high labor costs, and skyrocketing steel prices worldwide.

Dissatisfaction over Exchange and Interest Rates

16. (SBU) Nearly all our contacts expressed concern over the high prevailing level of interest rates and the continuing strength of the Real. Echoing past statements he has made to the press, FIESP President Paulo Skaf took to task the Lula government for the high SELIC baseline interest rate (currently 17.25 percent) and called for changes in the GOB's economic team. Finance Minister Palocci, he said, had fallen under the spell of interest rate hawks at the Central Bank and, given his lack of formal economic training, had proven unable to resist. Former Sao Paulo state Secretary for Science and Technology Emerson Kapaz, however, noted that in view of the confidence the market placed in Palocci, he did not expect the Finance Minister to depart the government prior to the October 2006 election. Separately, Charles Wortman, President of J.P. Morgan

BRASILIA 00000206 002 OF 005

Brazil forecast that the SELIC would drop to approximately 15 percent by the fourth quarter, a prediction roughly in line with the market consensus.

17. (SBU) The strength of the Brazilian Real versus the U.S. dollar provoked even greater concern. Ford's Barry Engel said that the strong Real complicated his company's exports, which in 2005 represented 42 percent of total production. While the company would do what it could to maintain its hard-won overseas markets, it much preferred the Real to trade at the 2.5 to 2.6 range - as opposed to its current 2.2 to 2.3 level. Suzano Paper executive Boris Tabacof stated that his company, along with a number of other firms as well, was suffering, as 2.8 was the equilibrium point.

18. (SBU) CIESP President Claudio Vaz worried that the strong real could make the country's US\$44 billion trade surplus disappear as quickly as it appeared. While the products Brazil sold abroad were varied, its export base was narrow: 40 companies were responsible for 45% of exports while 60 companies accounted for 65% of exports. Big business dominated the export sector, he noted, with the country's many small and medium-sized enterprises focusing on the domestic market. Caterpillar's exports, for instance, had risen from US\$150 million several years ago to US\$1 billion today. Both Vaz and Tabacof called for the Central Bank to intervene in the foreign exchange market to establish some type of floor for the value of the real.

FTAA and WTO

19. (SBU) The industry leaders we spoke to were of two minds on the trade agenda. While they felt that the Lula government's policy of seeking to expand South-South trade had resulted in the neglect of the bilateral trade relationship with the U.S., they blamed the USG's "failure to move on agriculture" for the impasse. Ford Mercosul President Antonio Maciel declared that given that three-fifths of those in the Brazilian congress had links to the farm industry, if the U.S. were to make concessions on agriculture the FTAA would be a done deal. In a separate conversation, FIESP International Affairs Director Roberto Gianetti da Fonseca opined that an agreement on agriculture in the Doha Round could pave the

way for resumption of FTAA talks, but argued that within the WTO the USG still needed to do more on domestic subsidies. Former Amb. to the U.S. Rubens Barbosa agreed that the USG was recalcitrant on the subsidies issue, and added that the close U.S. Senate vote on CAFTA ratification demonstrated that the United States did not have the requisite political will to make the concessions necessary to make an FTAA possible. Both Barbosa and Emerson Kapaz worried that any FTAA agreed to would be unbalanced in the USG's favor.

¶10. (SBU) In response, the Charge recounted the President's offer to do away with U.S. agriculture subsidies, provided that our WTO trading partners made concessions of similar magnitude. In addition, Charge noted Chile's experiences in the wake of the conclusion of the U.S.-Chilean FTA: both exports and GDP skyrocketed, while poverty rates declined. Trade liberalization, he declared, was the key to robust economic growth. Charge further observed that while within the FTAA context Brazil wanted greater access to the U.S. agricultural market and the U.S. wanted rigorous commitments in sectors such as services and IPR, it was up to each side's negotiators to hammer out a mutually-beneficial accord. Brazil's Foreign Ministry (Itamaraty) would have to advocate the GOB's interests while USTR would advance those of the USG.

¶11. (SBU) Gianetti, Barbosa, and former GOB Ambassador to France Sergio Amaral replied that under the current government Itamaraty was too apt to subordinate the business community's interests to the GOB's political agenda. The Charge agreed, observing that perhaps Brazil might consider breaking the Foreign Ministry's monopoly on trade negotiations and establishing an interagency unit, analogous to USTR. In a separate conversation, CIESP's Claudio Vaz endorsed the idea of a Brazilian USTR, calling for greater heat and less light in GOB trade policy. However, he cautioned that the USTR

BRASILIA 00000206 003 OF 005

concept likely would only come to fruition under a government led by the more business-friendly PSDB party. AmCham Advocacy Committee Director Geraldo Barbosa told us (privately) that in view of the limited results of the Doha Round Hong Kong meeting, Finance Minister Palocci was seeking to find a way to promote a "U.S.-Brazil FTA." Barbosa will meet with Palocci in May to follow up.

¶12. (SBU) Comment. In December 2005, AmCham had recounted to us similar statements by Palocci. Its unclear to us how serious the Minister is about his offer, although we will continue to track this. The good news from the Charge's overall discussions on trade liberalization is, however, that none of our interlocutors saw the idea of a Mercosul-U.S. 4+1 agreement as a panacea. Each recognized that the same issues (IPR, agriculture, services, etc.) which impede progress on the FTAA, would also make the negotiation of a comprehensive 4+1 accord difficult. End comment.

Bolivia, Venezuela, and Peru

¶13. (SBU) Views with respect to how best to promote regional stability were varied. Ford's Antonio Maciel opined that the entry of Venezuela into Mercosul would in the end have only political, as opposed to economic, significance. For Venezuela to become economically integrated into Mercosul, he said, it would have to depart the Andean Pact - a step it could not take given that the Andean Pact was its "natural cultural bloc." In a separate conversation, Roberto Teixeira da Costa, a prominent Sao Paulo-based businessman, fretted that the USG pays too little attention to Latin America, adding that if Lula were to be reelected, Chavez would likely try to exert greater leverage over Brazil through "checkbox diplomacy." Emerson Kapaz reiterated this point, noting that PDVSA is two and a half times the size of Brazil's Petrobras and was certainly capable of using its petrodollars to influence domestic policies.

¶14. (SBU) Charge stated the USG's disputes with Chavez principally stemmed from the fact that he meddled in the affairs of his neighbors through support for "anti-systemic" political groups. Such actions undermined democratic institutions both in Venezuela and the region. In addition, Charge noted, Chavez was a notoriously weak administrator. The country's oil wealth was not filtering down

to the masses, which were only growing poorer. Chavez put greater priority on assisting Cuba and buying Argentine bonds, than he did on the welfare of the Venezuelan people or the maintenance of the country's infrastructure (inter alia, the failing highway bridge between Caracas and the coast).

¶15. (SBU) Both Roberto Teixeira da Costa and Sergio Amaral averred that the U.S. and Brazil needed to cooperate more on regional stability issues. Bolivia President-elect Evo Morales was "unsophisticated," Amaral said, and Peruvian presidential candidate Ollanta Humala could be a danger as well. As for Chavez, Amaral continued, he was the greatest threat as he not only took the populist line in his public statements but in his actions as well. Separately, Claudio Vaz opined that now that Argentina President Kirchner's party had made legislative gains, Kirchner would be less confrontational vis-à-vis both the United States and Brazil. Now that Kirchner had strengthened his hand internally, Vaz thought, he would not need to continue to blame the country's problems on foreigners.

Serra, Alckmin, and Lula

¶16. (SBU) In the upcoming presidential race, our private sector interlocutors preferred Sao Paulo Governor Geraldo Alckmin over his fellow Tucano Jose Serra (currently Mayor of Sao Paulo city). (Note: PSDB party members are nicknamed Tucanos). AmCham officials recounted that they had surveyed businessmen at various recent Chamber meetings throughout the country. Although, admittedly, their poll was not necessarily representative, they stated that 97 percent of the respondents saw Alckmin as the best candidate.

BRASILIA 00000206 004 OF 005

AmCham Executive Director Artur Vasconcellos said that the private sector was impressed with the way Alckmin had promoted growth and economic development in the state. Alckmin was viewed as a talented manager, willing to sit down with all concerned to seek the best solution.

¶17. (SBU) In contrast, Gianetti described Serra as "voluntarioso" (rough translation: my way or the highway), i.e., he does not like to listen to contrary opinions. FIESP and CIESP officials exhibited a similar lean towards Alckmin, with Claudio Vaz echoing AmCham's praise of Alckmin's management skills and describing Serra as someone who believes that positive results flow from his policies rather than negotiated solutions. Kapaz and Amaral were more guarded in their assessments of the two, noting that both would make excellent candidates and the challenge for the PSDB would be to find a way to choose the nominee without splitting the party.

¶18. (SBU) The prospect of a Lula second term excited no one. Teixeira da Costa observed that given the ongoing political scandals, if reelected Lula would enter office with no honeymoon. This meant that it would be difficult for him to move forward on the wide range of difficult initiatives that both PT and opposition leaders recognized would have to be broached -- fiscal reform, social security reform, political party reform, tax reform, etc. -- during the next president's first 100 days in office. (In a separate conversation, Ford President Maciel opined that the next government also would need to quickly engage in additional trade opening, with increased imports helping to check inflation and further integrating Brazil into the world economy.) Both AmCham and FIESP officials noted that they were already raising these issues with political leaders so that once in office any new government could hit the ground running.

¶19. (SBU) Vaz was even more pessimistic about the prospect of Lula being reelected, stating that a Lula second term would be an "economic disaster." In the wake of the scandal, the PT bancada would likely fall from 90 to 50 or so, he said, thus forcing Lula to rely upon Chavez-style populism to garner support for his policies. Brazil's institutions would survive the cold bath, he concluded, but the country would be worse for the wear.

Way Forward for 2006

¶20. (SBU) The consensus among our contacts was that with the election set for October 2006, this would be a lost year in terms of the government's micro-reform agenda and the FTAA. Accordingly, FIESP and AmCham officials agreed that business to business dialogue would be the best way to make use of the time remaining before the election. Both FIESP and AmCham commented that the mutual goodwill created by the USG's decision to terminate the copyright piracy GSP review and the GOB's decision to refrain from compulsory licensing of anti-AIDS retrovirals created the climate for successful talks. The two organizations mapped out an array of upcoming events that they might (separately) pursue, including inter alia:

- intensified FIESP dialogue with the National Association of Manufacturers,
- organizing lobbying trips to Washington,
- scheduling an AmCham-U.S. Embassy Coordination Summit to discuss advocacy issues,
- continuing the industry sectoral discussions that AUSTR Broadbent initiated in December 2004, possibly in connection with any future visit to Sao Paulo by DUSTR Schwab,
- combined AmCham/CIESP matchmaking U.S. and Brazilian medium-sized firms, and
- discussion at the June 9-13 AACCLA Mid-year meeting in Rio de Janeiro.

¶21. (SBU) Finally, FCS Chief noted that the government-to-government Informal Commercial Exchange (ICE) talks contemplated for June 2006, possibly in connection with a visit by Commerce Secretary Gutierrez, also would be a step forward.

BRASILIA 00000206 005 OF 005

CHICOLA